

**PILOT LOCAL
GOVERNMENT
PARTNERSHIP PROGRAM**

**INFRASTRUCTURE
FINANCING AND
DEVELOPMENT STRATEGY
MODULE**

Prepared for



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PILOT LOCAL GOVERNMENT PARTNERSHIP PROGRAM

INFRASTRUCTURE FINANCING AND DEVELOPMENT STRATEGY MODULE

ISSUES IN OVERALL PILOT LGPP APPROACH

Introducing Integrated Management

A major strategy of the Pilot LGPP is to improve the capability and performance of local governments through the introduction of integrated municipal management in the pilot partner cities. While much effort is currently being dedicated to the design of the discrete Pilot LGPP modules, it is extremely important to clarify, from the beginning, the natural linkages between the modules and to devise a method to grow from the introduction of individual modules that are in priority demand at the gmina level to truly integrated municipal management.

Currently, Phase I of the Pilot LGPP process consists of initial contacts with the mayor and senior management of the gmina to determine the gmina's priority needs for technical assistance and training. At this stage, mayors will identify 2-3 projects or sectors where immediate technical assistance is needed from Pilot LGPP. Then sectoral teams are sent to the gmina under Phase II to clarify the issues in those sectors and propose a program of focused technical assistance in those areas under Phase III. Experience to-date shows that this approach is responsive to some critical priority needs of the gmina..... but it does not engender Integrated Management.

Therefore, it is proposed during Phase I to discuss how Pilot LGPP can respond to some priority needs on a focused basis while, at the same time, introducing the building blocks of more integrated management. For example, if a mayor feels that a specific economic development project is the highest priority, Pilot LGPP could provide focused technical assistance to that specific project but, at the same time, encourage the gmina to use the Gmina Financial Analysis Model to define the realistic ability of the gmina to finance the project.

The attached rocket-diagram shows some of the most important linkages that should exist between the modules. Using a similar schematic diagram of the linkages would be very useful in the Phase I discussion with mayors to demonstrate that many of the modules are complimentary and some should be implemented simultaneously. Note that the all of the modules have a strong linkage to the Gmina Financial Analysis Model which should be implemented early on in the Pilot LGPP program of any pilot partner city.

Growing Pilot LGPP Activities from Pilot Partners to All Self-Motivated Gminas

Some of the main tools of the Pilot LGPP (e.g. like the Gmina Financial Analysis Model, Standardized Loan Application, and others) have already been developed and

field tested and have demonstrated their usefulness and strong demand by gminas. It is proposed that work begin immediately to disseminate a selected set of these “core competencies” as widely as possible, as soon as possible. Priority should be given to providing pilot partners, as requested, but we should start now to build the capabilities of training institutes, consulting companies and other supporting institutions to offer some of these tools to a much wider audience, not just to the pilot partners.

While a pilot program with pilot partners can easily be implemented from a central office, reaching a large number of gminas on a sustainable basis will require some form of regional training and technical assistance centers. These centers will need to have internal capabilities in a set of “core competencies”, supplemented by specialized TA and training resources on an “as needed” basis in the more specialized competencies. Judging from the experience in pilot partners to date, the “core competencies” that are both in strong demand, are tightly linked and could be absorbed by a small core staff in regional centers, seem to revolve around the Infrastructure Finance, Strategic Management and Municipal Services & Enterprise Modules. The modules for Economic Development, Land Management and Housing seem to offer more specialized/tailored products which could probably be provided to all gminas from one or two centers of competence rather than from Pilot LGPP regional offices.

Therefore, it is proposed that 3-4 Pilot LGPP regional offices be established immediately in cooperation with established training institutions and that the Infrastructure Financing, Strategic Management, and Municipal Enterprise be the leading edge of the core competencies to be built up in the regional centers. The leading tool to be introduced broadly would be the Gmina Financial Analysis Model and associated tools that are already completed, tested and in the early phase of much broader dissemination.

Cost Recovery and Sustainability

Over the life of Pilot LGPP it is crucial to develop a strategy for ultimately reaching full recovery of costs of services being provided to gminas so that the training and technical assistance institutions and companies being trained can sustain the effort (technically and financially) at the end of Pilot LGPP.

APPROACH

Overview

This module will provide assistance to the large number of municipalities whose immediate priority is to finance major infrastructure investment projects; especially through use of long-term debt financing. Experience with gminas to-date shows there is a priority demand in almost every gmina for such assistance and that it can show immediate and

dramatic results which can cement the active, results-oriented partnership between Pilot LGPP and gminas.

Gminas are increasingly aware of the benefits of using long-term debt finance to increase immediate levels of investment, complete projects quickly and start to gain benefits from these projects as soon as possible; both to stimulate economic growth and meet basic service backlogs. However, gminas currently do not have the capability to competently prepare medium-term projections of their financial conditions and debt-carrying capacity or prioritize and program investments projects within their realistic financial limitations. These are all necessary skills for gminas which will use long-term debt finance. Once the gmina has made the decision to debt finance well prepared projects, support is then needed to help make the decision regarding the most appropriate form of financing (credits, bonds) and to actually do the financing.

Therefore, this module offers the following set of complimentary services to gminas:

- Gmina Financial Analysis — with initial emphasis on debt-carrying capacity and infrastructure programming
- Infrastructure Project Appraisal
- Infrastructure Long-term Debt Financing (by municipality and/or by enterprises)
 - Long-term Loans
 - Standardized Loan Applications
 - Marketing to banks
 - Bidding Procedures / Evaluation / Negotiation
 - Municipal Bonds
 - Prospectus / Information Memorandum
 - Bidding Procedures / Evaluation / Negotiation
- Infrastructure Project Management
- Capital Improvement¹ Planning (through linkage to the Strategic Management, Budget and Finance)

Exposure of the gmina Executive Board and City Council to the medium-term gmina financial analysis and “mini”-capital improvement planning techniques which are

¹ For consistency in terminology used in the text, and due to a number of legal implications the term of “Capital Investment” and/or “Capital Improvement” needs to be clarified and is defined herein as “project financed out of resources available for investments and debt service in Gmina budget and from external financing sources.”

necessary in order to competently secure long-term finance, creates an awareness and strong demand for a more integrated approach to gmina management. The Infrastructure Financing and Development Module will, therefore, be a strong leading element of the Pilot LGPP upon which to build related medium-term management systems improvements. Within the Infrastructure Module that includes assistance in improving the entire process of Investment Project Management from project conception to implementation. The Gmina Financial Analysis Model, to be applied by this Module, is also the logical starting point for activities offered by related Modules; especially the Strategic Management, Budget & Finance Module and Municipal Services & Enterprise Modules. This does not mean that the Infrastructure Financing and Development Module is the focal point of technical assistance delivered under Pilot LGPP, but that the kind of tools available within this module and level of their development support the most effective and fastest initiation of activities at the Gmina level and facilitate entry point for variety of other modules.

Most of the techniques and tools to be used and disseminated by this Module are already developed, pilot tested in early stages of much broader dissemination. This includes the Gmina Financial Analysis Model, the Standardized Loan Application, the Model Prospectus & Information Memorandum and, to some extent, Capital Improvement Planning. As these tools already have strong demonstrated demand from gminas and a track record of successful results, they will be the leading edge of disseminating “core competencies” to regional offices and a large number of gmina.

Tools

This Module will focus on the wide dissemination of a limited number of complimentary tools, most of which have proven very successful under the Municipal Advisory Program. Experience shows that techniques and tools must be both powerful and as simple as is practically possible, user-friendly (to Executive Board and City Council members as well as gmina staff), and yield meaningful and visible results as early as possible. A long development and/or implementation period dims the enthusiasm of the recipients of the assistance and thereby slows down the progress, affects the quality of the results and ultimately hinders our ability to disseminate them. The tool-driven approach will help to assure that the mayor and other key municipal officials who are making priority choices on technical assistance within the Pilot LGPP are not the only ones who understand the importance of such assistance.

It is equally important that the city personnel assigned to work with the advisors and consultants are convinced about the sense of cooperation, comprehend the results and need for the work and are genuinely motivated to make a contribution for helping their municipality to achieve selected objectives and most importantly, for making their own jobs easier, more interesting and more effective.

The positive results of Infrastructure Financing and Development Module tools application are equally achievable at any gmina regardless of size, economic base or financial condition. However, the type of benefits realized over the long term and the number of beneficiaries, e.g. mayor, executive board, gmina council, will depend on degree of tools utilization decided upon by the gmina itself.

The tool box of this Module includes:

Gmina Financial Analysis Model (GFAM) — Basic Version

The initial purpose of the Basic Version GFAM is to assess the debt-carrying capacity of a municipality in relation to the gmina's medium-term capital investment program- which will typically includes specific priority investment projects for immediate financing. The GFAM provides the capability to do medium-term projections of revenues, recurrent expenditures and the resulting expected surplus available for investment and/or debt service. The GFAM then helps the city prepare a "mini-capital improvement program" of priority investments that fits within the realistic financial limitations of the gmina, using long-term debt financing as appropriate. Application of the model provides the initial immediate results of:

- defining the debt-carrying capacity of the city and its realistic limitations so the gmina executive and council can decide whether or not to use debt-finance.
- defining a preliminary "mini-capital improvement plan", which is based on existing state of practice and information quality in a gmina but which forces the gmina management to adopt a medium-term perspective to investment priorities.
- providing a competent analysis which can be used for demonstrating credit-worthiness to commercial bank lenders and/or municipal bond investors.

These immediate results can equally be utilized in relation to commercial financing as well as any other type of subsidized financing available in Poland, such as loans from National and Voivodship Funds of Environmental Protection.

In eight successful applications in gminas ranging in size from 10,000 to over 1 million population, the implications of the GFAM application have typically reached far beyond the determination of municipalities debt carrying capacity to finance a specific infrastructure project. The leads to the natural and more far reaching secondary impacts of encouraging the gmina to:

- use it as a diagnostic tool in identifying key sectors where risks and opportunities for operational and performance improvement may be most productive to gmina management. For this purpose, additional capabilities will be created under the Strategic Management Module to expand upon the

GFAM-Basic Version. This will include more comprehensive revenue and recurrent expenditure analysis and projection capabilities as well as comparative performance analysis.

- build upon the “mini-CIP” to create a full scale multi-year capital improvement program, or at least adopt the GFAM in the interim to continue to do the less sophisticated “mini-CIP” on a regular basis.
- recognize the realistic financial constraints within which Economic Development Plans, Housing Strategies, etc. can be developed.

Infrastructure Project Appraisal Methodology and Criteria

The Pilot LGPP will provide assistance to gminas through appraisal of investment projects which have been prepared by the gmina for financing. This appraisal will provide the gmina a realistic independent opinion of the feasibility/desirability of proposed projects and how potential lenders/investors will perceive the project. Advice will be provided on what improvements are required to individual projects to make them “bankable” and what improvements must be made in the overall project preparation process of the gmina. It is therefore important to point out that actual preparation of project development documentation such as prefeasibility and feasibility studies, preliminary designs, etc. is not within the scope of offered technical assistance. MDA’s Standard Project Appraisal Methodology and Criteria will be introduced and applied. More specifically the following determinations will be made based on the application of specific Project Appraisal Criteria:

- Are the main objectives of the investment project clearly set and are the benefits associated with project’s implementation well defined.
- How advanced is the level of project development and is it sufficient for initiating the process of project financing.
- What is the status of project conformance with necessary permitting and regulatory requirements.
- Is implementation of the project in a proposed form going to satisfy the actual and anticipated needs and expectations of the municipality.
- How sensitive is the project to the possible changes requiring revisions in schedules, phasing, technology, size, etc., and resulting from differed social and economic requirements of the society.
- Is the municipality aware of and what are the impacts of the operating costs/revenues associated with proposed project implementation on municipal budget and/or the users.

Standardized Credit Application

This tool provides gminas a Standardized Loan Application that can be used by gminas to apply for competitive bids from a number of commercial banks. The Standardized Loan Application, combined with the GFAM, provides all of the information that should be required by potential commercial bank lenders in order to make the decision to approve a credit. This tool has also been successfully pilot tested and is accepted by numerous commercial banks which have already been trained in evaluation of gmina credit-worthiness.

It is anticipated that, after application of GFAM, gminas can use the Standard Loan Application format with minimal external assistance for quality control.

Model Prospectus and Model Information Memorandum

For gminas which have performed the GFAM and wish to issue bonds to finance their infrastructure investments, both a Model Prospectus and Model Information Memorandum (as well as supporting commentary and user manual) have been created. For very large issues (> 100 million PLN) which will be introduced into initial Public Trading on the WSE, the Model Prospectus provides guidance on how to prepare the required prospectus. For medium-small issues which will be privately placed and subsequently traded on the regulated secondary Over-the-Counter market, the Model Information Memorandum provides guidance.

It is anticipated that, after application of GFAM, gminas can use the Model Prospectus and Information Memorandum with minimal external assistance for quality control.

Commercial Credit & Municipal Bonds Bidding & Evaluation Procedures

Gminas are encouraged to establish competitive bidding procedures, in accordance with the Public Procurement Law, to obtain the best terms and conditions for credits and/or municipal bonds. This tool is essentially a compendium of the procedures which have been successfully applied to-date and can be recommended, with modification as required by each gmina's special circumstances.

The GFOA Munease Model has been adapted and adopted by the MDA and the Municipal Advisory Team for use in assisting gminas to evaluate bids using the True Interest Cost (TIC) methodology. This tool will be offered to gminas for evaluation of commercial credit offers and underwriting bids.

Infrastructure Project Management Manual

This manual will provide guidance to municipalities for all phases of infrastructure project planning and implementation. It will define all steps required from project

conception to execution with detailed guidance regarding appropriate contents of pre-feasibility study, feasibility study, preliminary design, detailed design, contract document, bidding procedures, financing procedures, etc. according to Polish best practices, laws and regulations. This tool is now being prepared under the Housing Finance and Municipal Advisory Program and will become available for use under the Pilot LGPP by fall of 1997. The purpose of this tool is to assist the municipalities that are at various stages of infrastructure project planning and implementation to set up proper procedures, to avoid potential problems and to maximize the technical and financial control of the project throughout all phases of its implementation as well as to resolve ongoing problems with infrastructure project management.

This tool should be of special importance to those municipalities that will receive assistance in securing the long term commercial financing, upon the understanding that the benefit of obtaining the most competitive rates and terms of the funds may be minimized or eliminated unless the use of these funds during the project implementation proceeds in accordance with most effective project management procedures.

All of the tools mentioned above will be developed and implemented with strong linkages to other modules, especially:

- GFAM-Basic Version to the GFAM expansion for more refined revenue and recurrent expenditure analysis and projection
- GFAM -CIP linkage. The CIP Models (to be implemented under the Strategic Management Module) are a natural linkage between the “front-end” planning instruments (Strategic Plan, Economic Development Plan, Spatial Plan) and the financial constraints defined in the GFAM and a refinement of the largely intuitive GFAM “mini-CIP”.
- Linkage between GFAM and the Municipal Service and Enterprise Financial Analysis Model to ensure compatibility of methodology, content and level of detail.

Technical Assistance and Training Delivery Approach

Framework of TA and Training Delivery

(Note: Joint Approach for Infrastructure Finance, Strategic Management and Municipal Services & Enterprises)

As most of the techniques and tools in the Infrastructure Financing and Development Module are already developed, tested and have demonstrated their usefulness and marketability, the strategy is to get these tools to a large number of gminas, supporting institutions and consulting companies as soon as possible, while giving the pilot partner gminas priority. The GFAM-Basic Version should be implemented early on in any pilot partner city, regardless of whether the gmina's initial priorities are in

Infrastructure Finance, Economic Development, Housing, Land Management.....because the gmina's financial constraints will invariably define the realm of possible solutions in each sector. Therefore, the GFAM and linked competencies should take a leading role in the broad dissemination strategy of the Pilot LGPP.

The Municipal Development Agency will be the primary technical counterpart at the national level for implementation of the Infrastructure Financing, Strategic Management and Municipal Services & Enterprises Modules. To ensure close cooperation on a daily basis and to maximize the technical transfer of skills from Pilot LGPP consultants to the MDA technical staff, the offices of the Pilot LGPP consulting team for these three modules will be co-located with the MDA.

A possible method for delivery of T/A and training to a large number of gminas could be through regional centers to be set-up in three-four locations throughout Poland. The regional centers would initially be set-up as project offices co-located with established local training institutions having both shared interests and some demonstrated level of capability in the lead competencies of the Pilot LGPP. Given the nature of this work it would make sense to set up the centers in locations most suitable to disseminate program outputs to other non-partner municipalities during the latter phase of program implementation. Presently there are 2,500 Polish gminas including almost 50 cities with population in excess of 100,000, relatively evenly distributed geographically around Poland. The preferred geographical locations would therefore seem to be Szczecin/Gdansk, Lublin, Krakow and Wroclaw. Ultimately the objective would be to reach all of those gminas that understand the benefits brought about by the Pilot LGPP and are motivated to self-improve. Location of the regional centers would also realistically depend on (1) where competent training institutes currently exist and (2) desired diffusion.

The strategy would be to start with the establishment of regional T/A and training centers built around a limited number of core competencies in the existing tools GFAM, Standardized Loan Application, Model Prospectus/Information Memorandum, and perhaps CIP and Task Based Budgeting. As the closely linked tools for the Strategic Management Module (Revenue and Expenditure Scan, Projection Planning and Management Systems Scan) and the Municipal Services and Enterprise Module (Municipal Antares Diagnostic Protocol and Enterprise Financial Condition Model) become available, these competencies would be transferred to the regional centers.

Initially, each of the centers could be staffed with two local infrastructure finance specialists trained in application of the GFAM-Basic Version. The primary function of the regional centers would be:

- direct and continuous communication with client gminas and potential client gminas in their region regarding application of tools from the 3 modules,

building from the GFAM to other linked tools and competencies as the gmina recognizes the needs and can absorb the TA and training;

- identifying and training local consulting resources for inclusion in the Pilot LGPP;
- contracting, management and quality control of the services delivered by these local consultants;
- direct cooperation with the partner training institution to develop its capabilities in delivering training courses on the tools and in providing on-site, hands-on training in application of the tools (to the extent the training institution is able and willing to provide such TA). It is recognized that most established training institutions currently involved in providing training to local governments have a strong desire to provide more technical assistance and on-site training than in the past. They want to have a more active role in the TA and training and not just provide a training site, “canned” courses and administrative support. Therefore, the relationships with each institution will have to evolve “organically” over time with a strong focus on developing and motivating institute staff.

Due to the availability of the tools and a limited number of consultants who have recently undergone formal training and are ready to commence the field application of GFAM, the Infrastructure Finance and Development Module appears to be best positioned to initiate work through the regional centers. As other modules/tools of the Pilot LGPP become ready to deliver T/A and training through the regional centers, additional Polish employees may be brought on board to supplement the capacity of those centers. A fully staffed regional center offering the core competencies in Infrastructure Finance, Strategic Management and Municipal Services and Management may be staffed by 3-4 Polish professionals, supported by local independent short-term consultants.

The work of the regional centers would be supervised by the Project Manager, Assistant Project Manager and supported by senior technical staff located in Warsaw. It is anticipated that some of the most challenging short-term TA assignments would have to be managed directly by the Warsaw office staff. Such assignments may include those that:

- significantly different from the typical T/A offered under the module. For example, this may be the case with the application of GFAM with an association of gminas as a partner;
- require specific advisory services not available to the regional centers through the local consultants. For example expertise necessary to advise a municipality on issuing Eurobonds;



- are expected to have very important implications on T/A offered by other modules of the Pilot LGPP.

Over the life of the Pilot LGPP it is crucial to develop a strategy for ultimately reaching full recovery of costs of services being provided to gminas so that the training and technical assistance institutions and companies being trained can sustain the effort (technically and financially) at the end of Pilot LGPP.

Delivery Approach for Providing Infrastructure Financing and Development Assistance to Specific Gminas

Based on the experience gained in 10 gminas to-date, the following is the normal progression of activities to be implemented in each gmina requesting assistance:

- gmina request for assistance in long-term debt financing (credit or bond) of a specific infrastructure project
- initial visit to gmina for:
 - preliminary discussion of specific investment projects to be financed
 - preliminary discussion of financing required, possible sources, budgets
 - preliminary review of gmina's project management process and capabilities
 - introduce GFAM and data collection requirements for gmina
 - presentation to Executive Board & City Council on benefits of long-term debt financing and introduction of process
- implement GFAM and Investment Project Appraisal:
 - one week on-site work with city staff for compilation of historic budget data, revenue/recurrent revenue projections and initial review/compilation of infrastructure project plans (normally non-existent). Concurrently, perform technical appraisal of investment projects.
 - one week off-site to input to GFAM and prepare preliminary results
 - one week to present preliminary results to Executive Board, work with gmina to prioritized investment projects and adopt long-term financing strategy within surplus available. Presentation to Executive Board & City Council
- City Council approval for long-term financing of specific project, using credit or bond
- if commercial credit financing will be used:
 - introduce Standardized Loan Application. City to complete using GFAM as basic data source. Quality control assistance provided, as required.

- advise gmina on bidding procedures to be established, help identify short-list of commercial banks with active municipal lending programs. Assist in marketing to banks.
- advise gmina on bid evaluation (using TIC model).
- advise during negotiations and contracting of loans.
- if municipal bond will be used:
 - advise on type of bond/placement which is most practical
 - advise gmina on preparation of Prospectus or Information Memorandum
 - advise gmina on establishing underwriter bidding procedure
 - advise gmina on bid evaluation (using TIC model), negotiations and contracting
 - advise gmina on procedures for public trading of bond, if appropriate.
- Throughout the above process, critical deficiencies (both in the specific investment project to be financed and in the general project management system of the gmina) will be identified. The Project Management Manual will be introduced and selective corrective actions will be recommended to the gmina. Technical assistance will be provided as appropriate.
- Follow-up technical assistance and training will be provided to those gminas wishing to adopt the GFAM as a continuing tool for medium-term planning and/or to gradually evolve from the GFAM to full scale implementation of a comprehensive CIP.

BEST PRACTICE GUIDE

Executive Summary

With the ongoing political and economical decentralization process in Poland and with increased citizens involvement in local government decision making process, the public requests for provision of services and investment projects to improve the overall standard of living, receive more attention at the local level. One of the most challenging questions faced today by the local government officials is how to maximize the volume of capital improvement projects for direct benefit of citizens and for stimulating of economic development of the municipality given the limited budget resources available. There is almost no municipality that would not be currently involved in an active phase of infrastructure project planning or implementation. At the same time, these capital improvement projects can create serious impacts on municipality's overall financial standing and require searching for new or alternative methods of project financing.

To achieve the desired results it is of utmost importance to initiate assistance through the application of quick and effective tools to develop a medium term capital

investment program, to make a multi-year budget projections and to assess the most suitable investment projects schedule and a corresponding project financing plan.

The Infrastructure Finance and Development Module is best positioned to assist municipalities in the above tasks. It offers the tools ready for use and tested through pilot programs, which have already been successfully applied in 10 Polish municipalities ranging in size from 10,000 to 1.6 million population, yielding quick yet effective and measurable solutions to the long term planning and financing of infrastructure projects. The complimentary services and training to gminas with the use of tools available under this module include the following:

- *Gmina Financial Analysis Model (GFAM) application* - with initial emphasis on defining debt carrying capacity and on infrastructure programming
- *Infrastructure Project Appraisal* -to provide the gmina a realistic independent opinion of the feasibility/desirability of proposed projects and to suggest the necessary revisions to make the project “bankable”
- *Infrastructure Long-term Debt Financing* (by municipality and/or by enterprises)
 - *Long-term Loans* (Standardized Loan Applications/Marketing to Banks/Bidding Procedures/Evaluation/Negotiation)
 - *Municipal Bonds* (Prospectus/Information Memorandum/Bidding Procedures/Evaluation/Negotiation)
- *Infrastructure Project Management* - to assist the municipalities that are at various stages of infrastructure project planning and implementation to set up proper procedures for avoiding potential problems and for maximizing the technical and financial control of the project throughout all phases of its planning and implementation and for resolving ongoing problems with infrastructure project management.
- *Capital Investment Planning* - through linkage to the Strategic Management, Budget and Finance Module

The ultimate goal of the program with regards to provision of technical assistance offered under the Infrastructure Financing and Development Module is for the municipality to become proficient in long term planning of budgets and scheduling of capital projects accompanied by prudent use of long term funds presently available on Polish capital markets for municipal infrastructure projects financing. The work under this module is also expected to create the links for technical assistance delivery through other modules, e.g., Strategic Management, Budgeting and Finance as well as Strengthen Municipal Services and Enterprises in particular.

Some of the most important benefits arising from technical assistance and application of tools available under Infrastructure Financing and Development Module include the following:

- Stimulation of most effective use of gmina financial resources
- Promotion of transparency through provision of effective tool (GFAM) for internal and external communication, e.g. for Executive Board to communicate with Gmina Council, with Department Managers and with citizens and for Gmina to communicate with potential investors and with financing institutions.
- Optimization of Strategic Planning through implementation of medium to long term budget and investment program planning procedure.
- Establishment of financial framework for all forms of Gmina operations
- Introduction of debt management system
- Improvement in efficiency of multi-year project management
- Facilitation of analysis of economic development's impact on Gmina budget
- Stimulation of municipal enterprises restructuring process.

Overview

Gminas are becoming increasingly aware of the potential benefits of using long-term debt financing to immediately increase levels of infrastructure investment; both to stimulate economic growth and meet basic service backlogs. Long-term debt financing allows credit-worthy gminas to implement projects now and pay for them as the infrastructure is used. Such long-term debt financing is done throughout the world. In the US, there is about \$5,000 of local government long-term debt per person for infrastructure, financed primarily through municipal bonds. In Western Europe, such financing is mainly through credits.

Until recently, the sources of long-term debt financing available to Polish gminas for infrastructure investments were limited primarily to subsidized National and Voivodship Environmental Fund loans and loans from multi-lateral and bi-lateral lending programs (IBRD, EBRD, etc.). Now, these sources are being complimented by growing domestic commercial bank lending to gminas and the development of the municipal bonds market. While gminas will naturally want to use subsidized lending as much as possible to meet their financing needs, many gminas are willing to borrow at commercial interest rates for projects that do not qualify for subsidized lending and for "gap" financing. "Gap" financing occurs where a gmina can cover a major portion of project financing from NFOS/WFOS loans and some internal sources but must borrow the remainder at commercial rates to finish the project quickly and start receiving benefits from it.

If a gmina is going to use long-term debt finance (regardless of whether this is with subsidized loans, commercial loans or municipal bonds) it must have the capability to understand its debt-carrying capacity over the medium-term future and to competently schedule its investment program within its realistic financial limitations. Instead of a one-year horizon on budgeting and investment planning, gminas must start to adopt a medium-term (5-7 year) perspective and planning techniques. These are necessary skills for gminas which wish to use long-term debt finance so that they can demonstrate to themselves, the public and financial institutions that they are indeed credit-worthy,

responsible borrowers and that they do have credible, reasoned plans for the future. Once the gmina has made the decision to debt finance well prepared projects, support is then needed to help make the decision regarding the most appropriate form of financing (credits, bonds) and to actually do the financing.

Therefore, this module offers the following set of complimentary services and training to gminas:

- Gmina Financial Analysis Model — with initial emphasis on defining debt-carrying capacity and on infrastructure programming
- Infrastructure Project Appraisal
- Infrastructure Long-term Debt Financing (by municipality and/or by enterprises)
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 - Marketing to banks
 - Bidding Procedures / Evaluation / Negotiation
 - Municipal Bonds
 - Prospectus / Information Memorandum
 - Bidding Procedures / Evaluation / Negotiation
- Infrastructure Project Management
- Capital Investment² Planning (through linkage to the Strategic Management, Budget and Finance Module)

Exposure of the Gmina Executive Board and Gmina Council to the medium-term gmina financial analysis and “mini”-capital investment planning techniques which are necessary in order to competently secure long-term finance, creates an awareness and strong demand for a more integrated approach to gmina management. The Infrastructure Financing and Development Module will, therefore, be a strong leading element of the Pilot LGPP upon which to build related medium-term management systems improvements. Within the Infrastructure Module that includes assistance in improving the entire process of Investment Project Management from project conception to implementation. The Gmina Financial Analysis Model, to be applied by this Module, is also the logical starting point for activities offered by related Modules; especially the Strategic Management, Budget & Finance Module and Municipal Services & Enterprise Modules. This does not mean that the Infrastructure Financing and Development Module

² For consistency in terminology used in the text, the term “Capital Investment” is defined as “project financed out of resources available for investments and debt service in Gmina budget and from external financing sources.”

is the focal point of technical assistance delivered under Pilot LGPP, but that the kind of tools available within this module and level of their development support the most effective and fastest initiation of activities at the Gmina level and facilitate entry point for variety of other modules.

Most of the techniques and tools to be used and disseminated by this Module are already developed, pilot tested and are in early stages of much broader dissemination. This includes the Gmina Financial Analysis Model, the Standardized Loan Application, the Model Prospectus & Information Memorandum and, to some extent, Capital Investment Planning. As these tools already have strong demonstrated demand from gminas and a track record of successful results, they would be the leading edge of disseminating “core competencies” to regional offices and a large number of gmina; with first priority given to supporting the pilot partner cities.

There is a number of broad range benefits that can relatively quickly and effectively be realized by local government upon implementation of tools available through the Infrastructure Financing and Development Module with Gmina Financial Analysis Model as a leading tool. Aside from the benefit of facilitating access to alternative long-term financing sources for infrastructure projects, one of the most important benefits is instituting an effective management and communication tool for the Executive Board. GFAM as a communication tool facilitates transparency in decision making process and allows conveyance of information on proposed budgets, capital improvement plans, financing options, etc. to Gmina Council, to Department Managers and ultimately to citizens. This information is presented in simple format easy to understand by individuals without formal financial or managerial training. Likewise, the Gmina as a whole, improves its ability to clearly communicate information to external entities such as potential investors and financing institutions.

Other important benefits stemming from application of tools available under Infrastructure Financing and Development Module include optimization of strategic planning through introduction of medium to long-term budget projection and investment planning procedure, introduction of debt management system, establishing financial framework for all forms of gmina operations, improvement in management of multi-year investment projects, and stimulation of restructuring of municipal enterprises.

Tools

This Module contains a limited number of complimentary tools, most of which have proven very successful under the Municipal Advisory Program. Experience shows that techniques and tools must be both powerful and as simple as is practically possible, user-friendly (to Executive Board and City Council members as well as gmina staff), and yield meaningful and visible results as early as possible. The positive results of Infrastructure Financing and Development Module’s tools application are equally achievable at any gmina regardless of size, economic base or financial condition. However, the type of



benefits realized over the long term and the number of beneficiaries, e.g. mayor, executive board, gmina council, will depend on degree of tools utilization decided upon by the gmina itself.

The tool box of this Module includes:

Gmina Financial Analysis Model (GFAM) - Basic Version

The initial purpose of the GFAM - Basic Version is to assess the debt-carrying capacity of a municipality in relation to the gmina's medium-term capital investment program- which will typically includes specific priority investment projects for immediate financing. The GFAM provides the capability to do medium-term projections of revenues, recurrent expenditures and the resulting expected surplus available for investment and/or debt service. The GFAM then helps the city prepare a "mini-capital improvement program" of priority investments that fits within the realistic financial limitations of the gmina, using long-term debt financing as appropriate. Application of the model provides the initial immediate results of:

- defining the debt-carrying capacity of the city and its realistic limitations so the gmina executive and council can decide whether or not to use debt-finance.
- defining a preliminary "mini-capital improvement plan", which forces the gmina management to adopt a medium-term perspective to investment priorities
- providing a competent analysis which can be used for demonstrating credit-worthiness to commercial bank lenders and/or municipal bond investors.

These immediate results can equally be utilized in relation to commercial financing as well as any other type of subsidized financing available in Poland, such as loans from National and Voivodship Funds of Environmental Protection.

In ten successful applications in gminas ranging in size from 10,000 to over 1 million population, the implications of the GFAM application have typically reach far beyond the determination of municipalities debt carrying capacity to finance a specific infrastructure project. The leads to the natural and more far reaching secondary impacts of encouraging the gmina to:

- use it as a diagnostic tool in identifying key sectors where risks and opportunities for operational and performance improvement may be most productive to gmina management. For this purpose, additional capabilities will be created under the Strategic Management Module to expand upon the GFAM-Basic Version. This will include more comprehensive revenue and recurrent expenditure analysis and projection capabilities as well as comparative performance analysis.

- build upon the “mini-CIP” to create a full scale multi-year capital improvement program, or at least adopt the GFAM in the interim to continue to do the less sophisticated “mini-CIP” on a regular basis. The distinction between “mini-CIP” and the full scale CIP is that the “mini-CIP” is done based on existing information quality available at a gmina. while the full CIP is to improve the information quality with respect to planning, technical and cost justification, and scheduling of investment projects throughout the process and package it properly for city staff, political leadership and citizens.
- recognize the realistic financial constraints within which Economic Development Plans, Housing Strategies, etc can be developed.

Infrastructure Project Appraisal Methodology and Criteria

The Pilot LGPP provides assistance to gminas through appraisal of investment projects which have been prepared by the gmina for financing. This appraisal provides the gmina a realistic independent opinion of the feasibility/desirability of proposed projects and how potential lenders/investors will perceive the project. Advice is provided on what improvements are required to individual projects to make them “bankable” and what improvements must be made in the overall project preparation process of the gmina. It is therefore important to understand that actual preparation of project development documentation such as prefeasibility and feasibility studies, preliminary designs, etc. is not within the scope of offered technical assistance.

MDA’s Standard Project Appraisal Methodology and Criteria will be introduced and applied.

More specifically the following determinations will be made based on the application of specific Project Appraisal Criteria:

- Are the main objectives of the investment project clearly set and are the benefits associated with project’s implementation well defined.
- How advanced is the level of project development and is it sufficient for initiating the process of project financing.
- What is the status of project conformance with necessary permitting and regulatory requirements.
- Is implementation of the project in a proposed form going to satisfy the actual and anticipated needs and expectations of the municipality.
- How sensitive is the project to the possible changes requiring revisions in schedules, phasing, technology, size, etc., and resulting from differed social and economic requirements of the society.
- Is the municipality aware of and what are the impacts of the operating costs/ revenues associated with proposed project implementation on municipal budget and/or the users.

Standardized Credit Application

This tool provides gminas a Standardized Loan Application that can be used by gminas to apply for competitive bids from a number of commercial banks. The Standardized Loan Application, combined with the GFAM, provides all of the information that should be required by potential commercial bank lenders in order to make the decision to approve a credit. This tool has also been successfully pilot tested and is accepted by numerous commercial banks which have already been trained in evaluation of gmina credit-worthiness.

It is anticipated that, after application of GFAM, gminas can use the Standard Loan Application format with minimal external assistance for quality control.

Model Prospectus and Model Information Memorandum

For gminas which have performed the GFAM and wish to issue bonds to finance their infrastructure investments, both a Model Prospectus and Model Information Memorandum (as well as supporting commentary and user manual) have been created. For very large issues (> 100 million PLN) which will be introduced into initial Public Trading on the WSE, the Model Prospectus provides guidance on how to prepare the required prospectus. For medium-small issues which will be privately placed and subsequently traded on the regulated secondary Over-the-Counter market, the Model Information Memorandum provides guidance.

It is anticipated that, after application of GFAM, gminas can use the Model Prospectus and Information Memorandum with minimal external assistance for quality control.

Infrastructure Project Management Manual

This manual will provide guidance to municipalities for all phases of infrastructure project planning and implementation. It will define all steps required from project conception to execution with detailed guidance regarding appropriate contents of pre-feasibility study, feasibility study, preliminary design, detailed design, contract document, bidding procedures, financing procedures, etc. according to Polish best practices, laws and regulations. This tool is now being prepared under the Housing Finance and Municipal Advisory Program and will become available for use under the Pilot LGPP by fall of 1997. The purpose of this tool is to assist the municipalities that are at various stages of infrastructure project planning and implementation to set up proper procedures for avoiding potential problems and for maximizing the technical and financial control of the project throughout all phases of its planning and implementation as well as for resolving ongoing problems with infrastructure project management.

This tool should be of special importance to those municipalities that will receive assistance in securing the long term commercial financing, upon the understanding that the benefit of obtaining the most competitive rates and terms of the funds may be minimized or eliminated unless the use of these funds during the project implementation proceeds in accordance with most effective project management procedures.

All of the tools mentioned above will be developed and implemented with strong linkages to other modules, especially:

- GFAM-Basic Version to the GFAM expansion for more refined revenue and recurrent expenditure analysis and projection
- GFAM -CIP linkage. The CIP Models (to be implemented under the Strategic Management Module) are a natural linkage between the “front-end” planning instruments (Strategic Plan, Economic Development Plan, Spatial Plan) and the financial constraints defined in the GFAM and a refinement of the largely intuitive GFAM “mini-CIP”.
- Linkage between GFAM and the Municipal Service and Enterprise Financial Analysis Model to ensure compatibility of methodology, content and level of detail.

Technical Assistance and Training Delivery Approach

As most of the techniques and tools in the Infrastructure Financing and Development Module are already developed, tested and have demonstrated their usefulness and marketability, the strategy is to get these tools to a large number of gminas as soon as possible, while giving the pilot partner gminas priority. The GFAM-Basic Version should be implemented early on in any pilot partner city, regardless of whether the gmina's initial priorities are in Infrastructure Finance, Economic Development, Housing, Land Management.....because the gmina's financial constraints will invariably define the realm of possible solutions in each sector.

Based on the experience gained in 10 gminas to-date, the following is the normal progression of activities to be implemented in each gmina requesting assistance:

- gmina request for assistance in long-term debt financing (credit or bond) of a specific infrastructure project
- initial visit to gmina for:
 - preliminary discussion of specific investment projects to be financed
 - preliminary discussion of financing required, possible sources, budgets
 - preliminary review of gmina's project management process and capabilities
 - introduce GFAM and data collection requirements for gmina
 - presentation to Executive Board & City Council on benefits of long-term debt financing and introduction of process
- implement GFAM and Investment Project Appraisal:
 - one week on-site work with city staff for compilation of historic budget data, revenue/recurrent revenue projections and initial review/compilation of infrastructure project plans (normally non-existent). Concurrently, perform technical appraisal of investment projects.
 - one week off-site to input to GFAM and prepare preliminary results
 - one week to present preliminary results to Executive Board, work with gmina to prioritized investment projects and adopt long-term financing strategy within surplus available. Presentation to Executive Board & City Council
- City Council approval for long-term financing of specific project, using credit or bond
- if commercial credit financing will be used:
 - introduce Standardized Loan Application. City to complete using GFAM as basic data source. Quality control assistance provided, as required.

- advise gmina on bidding procedures to be established, help identify short-list of commercial banks with active municipal lending programs. Assist in marketing to banks.
- advise gmina on bid evaluation (using TIC model).
- advise during negotiations and contracting of loans.
- if municipal bond will be used:
 - advise on type of bond/placement which is most practical
 - advise gmina on preparation of Prospectus or Information Memorandum
 - advise gmina on establishing underwriter bidding procedure
 - advise gmina on bid evaluation (using TIC model), negotiations and contracting
 - advise gmina on procedures for public trading of bond, if appropriate.
- Throughout the above process, critical deficiencies (both in the specific investment project to be financed and in the general project management system of the gmina) will be identified. The Project Management Manual will be introduced and selective corrective actions will be recommended to the gmina. Technical assistance will be provided as appropriate.
- Follow-up technical assistance and training will be provided to those gminas wishing to adopt the GFAM as a continuing tool for medium-term planning and/or to gradually evolve from the GFAM to full scale implementation of a comprehensive CIP.

Related Case Studies

Significant experience in technical assistance delivery in the area of Infrastructure Finance and Development has already been gained from the ongoing USAID's Housing Finance and Municipal Advisory Program. Several important tools such as Gmina Financial Analysis Model, Standard Credit Application Package, Model Information Memorandum or Model Prospectus described earlier have been developed and implemented at selected Polish municipalities. There are currently 10 municipalities that received technical assistance in Infrastructure Finance and Development. The following case studies represent excellent reference for practical benefits and results associated with related work already completed in Poland.

Kutno - Long-Term Commercial Credit

■ **Background.** After exhausting all of the available financing sources, including grants and state subsidized loans, the executive board of the City decided to evaluate the use of commercial credits to finalize the completion of the wastewater infrastructure project.

■ **Activities.** In early 1995, the Municipal Advisory Team of the Housing Finance and Municipal Advisory Program working with the Municipal Development Agency initiated technical assistance for the City of Kutno by developing Gmina Financial Analysis Model and a Standard Credit Application Package. No similar tools were available on the Polish market. The Gmina Financial Analysis Model was utilized for making ten year projections of municipal budget revenues and expenditures and the resulting funds available for investment and debt service. Using the model the City was able to realistically schedule a capital investment plan and apply various debt financing scenarios. Implementation of the model required assessment of historic revenue and expenditure data and assumptions for future projections as well as preparation of a “mini” capital investment plan; refining of the initial analysis of available funds an capital project scheduling, and presentation of the final analysis and recommendations to the Executive Board and City Council. As the output of the model presents a clear and easy to understand format supported by graphical presentation, the report proved to be extremely useful in making the city understand its long term debt carrying capacity and allowed the City Council to give an overwhelming approval for commercial credit financing of the PLN 1.2 million required. Subsequently, the City was assisted in developing a standard credit application package which, along with gmina financial analysis report, represented a set of materials submitted to selected commercial banks. During the prebid conference, the banks interested in providing offers were trained on methodology of evaluating municipal debt carrying capacity utilized in a gmina financial analysis model.

■ **Results.** Based on the information submitted to banks, the City of Kutno received very competitive bids from all six of the commercial banks invited to bid. In June 1996, Kutno obtained the first substantial post - World War II long-term municipal infrastructure loan from commercial bank own funds. The Gmina Financial Analysis Model was adopted by the City as a tool for making medium to long term projections of municipal budgets and for multi year planning of capital investment program. In the fall of 1996, the City of Kutno independently planned and obtained a second 3.0 million PLN commercial credit for financing of an economic development project. As the City has already gained experience in credit application package preparation and established its creditworthiness with the banks, the timeframe for receiving the funds was substantially reduced and the terms of the loan received were extremely competitive.

Ostrów Wielkopolski - Municipal Bond

■ **Background.** The City of Ostrów Wielkopolski planned to issue an initial municipal bond in 1996 for PLN 7.5 million to finance construction of urban roads. The City wished to initially place the bonds privately and then have the bonds publicly traded on the new Over-the-Counter (OTC) market. This public trading would help establish the city’s reputation in the financial community in order to lower costs of subsequent bond issues and for publicity to attract direct investors in enterprises and businesses in the progressive gmina of Ostrów Wielkopolski.

■ **Activities.** With technical assistance from the Municipal Advisory Project, the city used the Gmina Financial Analysis Model to measure their debt-carrying capacity and to elaborate their mini-capital investment program within their financial limitations ---- prior to issuing the bond. This helped convince the Executive Board, City Council, local citizens and potential investors of the feasibility of issuing the planned bond. Information from the Gmina Financial Analysis was then used as the basis for preparation of the Information Memorandum. Using the Information Memorandum as the basic document, the City applied to the Securities Commission for permission to trade their bond on the regulated secondary OTC market.

■ **Results.** The Polish Securities Commission approved the application on December 19, 1996 and the bond should enter public trading early in 1997. Exploiting its solid reputation for sound financial management, the City is now independently using the Gmina Financial Analysis and the Model Information Memorandum to prepare for a second issue of PLN 10 million in 1997. The municipal bonds market has benefited greatly from Ostrów Wielkopolski's active and aggressive participation as a pilot city in all of these activities which are leading to a rapid growth of a healthy market.

Other Municipalities

■ **Background.** To date eight other municipalities have received technical assistance in the area of infrastructure project financing. The municipalities ranged in size from 10,000 to 1.6 million population and have entered into a program with an intent to finance selected infrastructure projects either by issue of municipal bonds or by long-term commercial credits.

■ **Activities.** Technical assistance delivered at all eight municipalities involved application of Gmina Financial Analysis Model to determine a debt carrying capacity of municipal budgets and to help establishing a realistic multi year mini capital improvement program based on various projects scheduling and financing scenarios.

■ **Results.** The results of technical assistance to the eight other municipalities are as follows:

- two municipalities were advised against incurring additional debt due to insufficient debt carrying capacity.
- one municipality has proved its creditworthiness to the Voivodship Fund of Environmental Protection and qualified for additional preferential loan on the project.
- one municipality received support for issuing of municipal bond by demonstrating its sufficient debt carrying capacity.
- two municipalities were able to determine the maximum cost of the municipal transport investment projects that the cities can afford and are now in a process of finalizing credit application packages for medium term commercial financing.



- one municipality has been advised to seek alternative options, e.g., BOT concept of utility project financing, that would not involve debt service out of municipal budget, as the budget was determined to have an insufficient debt carrying capacity.
- one municipality is presently in a process of analyzing the feasibility of issuing a bond on the Euromarket.

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